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TAGS: [ENRG](#) [EINV](#) [EPET](#) [ECON](#) [AR](#)
SUBJECT: ARGENTINE ENERGY SHORTAGE - A CRISIS FORETOLD

REF: A. 2006 BUENOS AIRES 2808

- [1](#)B. BUENOS AIRES 1369
- [1](#)C. BUENOS AIRES 1352
- [1](#)D. BUENOS AIRES 1278
- [1](#)E. BUENOS AIRES 1128
- [1](#)F. BUENOS AIRES 880
- [1](#)G. BUENOS AIRES 844
- [1](#)H. BUENOS AIRES 65

Classified By: Ambassador E.A. Wayne for Reasons 1.4 (b,d)

Summary

[1](#)1. (SBU) A combination of an unusually cold winter, unseasonably low water levels at hydro-electric facilities, and a 5-year post-crisis legacy of under-investment in basic electricity and natural gas infrastructure has resulted in significant energy shortages in Argentina. The consequence: Over the past month, GoA-mandated cutbacks in electricity and gas consumption by major wholesale consumers have depressed industrial production; rolling blackouts in major urban areas have sparked protests by residential consumers; and cutbacks in the availability of compressed natural gas used by many automobiles and most taxis in Argentina have disrupted transit.

[1](#)2. (C) After months of public denials by senior GoA officials, including by Planning Minister De Vido, ("there is no crisis") and efforts to lay the blame on under-investment by profit-hungry private energy companies, the GoA has announced a series of band-aid measures, including purchases of electricity from Brazil and a "Total Energy" plan to increase thermo-electric generation via subsidized supplies of diesel, that are designed to carry the nation through to (warm weather) presidential elections in October. Notably absent has been any move to limit consumption by adjusting domestic electricity and natural gas tariffs that remain far below market rates in neighboring Chile and Brazil, or as of

yet by encouraging even minimal energy conservation efforts. Despite growing criticism of the GoA's short-sighted approach to energy planning, the Kirchner administration appears positioned to weather this crisis relatively unscathed: The still-booming economy trumps all and energy shortage constraints on industrial production will likely only lower strong GDP growth (projected in the 7.5%-8.0% range for 2007) by a few tenths of a percent. Like the various corruption scandals afflicting the Kirchner administration and a number of recent electoral setbacks for Kirchner-backed candidates in Buenos Aires and the provinces, the near term impact of the energy crisis is troublesome for the government but is unlikely to significantly impact October presidential elections. End Summary

Excess Demand Underinvestment = Capacity Shortfall

13. (U) Argentina has the third-largest power market in Latin America, relying largely on natural gas-fired thermal plants and hydropower for most of its electricity supply. With approximately 17-18 gigawatts (GW) of installed, available generation capacity, 61% of Argentina's electricity production is fossil fuel-based (primarily natural gas) and 35% is hydroelectric.

14. (SBU) Following the 2001/2 economic crisis, the GoA froze wholesale and retail electricity and gas prices at significantly devalued peso levels, reduced capacity payments to electricity generators, and changed the structure of electricity spot pricing so as to make investments in generation, particularly in marginal (peaking) capacity, much less attractive. These interventions resulted in an electricity sector pricing mechanism for the wholesale generation market that provides few incentives for new greenfield investment in the energy sector. Further, private electricity sector players here (including U.S. companies) say that the GoA's freezing of energy prices and manipulation of the methodology used to set market prices have unilaterally abrogated contracts, effectively confiscating funds owed to them. The consequence has been a raft of international ICSID arbitration claims filed against the GoA that total in the billions of dollars (Refs E and H).

15. (SBU) Frozen domestic electricity and natural gas rates that remain far below international market levels (Argentine residential users pay roughly 25% and industrial users pay roughly 50% of rates users pay in neighboring Chile and Brazil) have encouraged extraordinary annual increases in domestic demand, raising generating capacity utilization to internationally accepted limits. As a consequence, independent industry analysts have been floating predictions of Argentine energy shortages and disruptions for the past three years. Until recently, energy crises have been averted by a combination of luck (mild summers and winters) and measures adopted by the GoA to increase short term energy supply, including negotiations with Bolivia in 2003 to ramp up imports of natural gas; the unilateral abrogation of Argentine natural gas supply contracts to Chile in 2004; and GoA pressure on domestic downstream refiners (including the U.S.' Esso) to address diesel fuel shortfalls by importing supplies and on-selling to domestic consumers at a loss. During this period, the GoA publicly accused foreign-controlled energy companies and analysts who were predicting imminent energy shortfalls of crying wolf, attributing growing energy capacity constraints to Argentina's remarkable 8 % rates of GDP growth over the past four years.

Current Crisis: Bad Weather Capacity Constraint

16. (SBU) The proximate cause of Argentina's current energy crisis is higher than anticipated increase in electricity demand due to a very cold winter. Low energy prices have led to steadily increasing residential electricity demand, as

Argentina's economic recovery has dramatically increased the sale of power-hungry consumer white goods. National residential electricity demand, which accounts for roughly 41% of total electricity demand, was up 17.4% y-o-y in June 2007. In the Greater Buenos Aires metropolitan area (which accounts for a full 55% of national consumption), total demand was up 10% y-o-y in June 2007.

17. (SBU) On June 14, as a polar front covered much of Argentina and unseasonably low rainfall limited hydro-electric production, the maximum design capacity of the electrical system of 18,400 MW was reached and urban areas began experiencing rolling blackouts, mostly in lower income neighborhoods. The GoA responded by requiring distributors to maintain supplies to residential customers while requiring large industrial users to cut back consumption by up to one third during peak consumption hours of 16:00 - 21:00. In addition, natural gas feedstock supplies to residential customers were prioritized at the expense of supplies to some electricity generating plants that were forced to use significantly more expensive and less energy efficient imported diesel fuel. Supplies were also cut back to Chile and to large domestic industrial users who generate their own power, and to petrochemical and agrochemical companies (including U.S. players Dow Chemical and Eastman Chemical) who use natural gas as a raw material feedstock. Industrial production suffered, with a number of energy-intensive industrial sectors (steel, aluminum) hit particularly hard.

18. (SBU) In late June, compressed natural gas (CNG) supplies were also cut in favor of residential heating customers during the cold wave. Argentina is the world's fourth largest user CNG, primarily to fuel cars and light trucks, with expanded consumption driven by CNG prices set substantially below (already below international market) gasoline prices. Natural gas represents 15% of total fuel used in Argentina for transportation. The 35,000-strong Greater Buenos Aires taxi fleet is largely CNG powered and cutbacks forced many commuters to use already overcrowded buses to get to work. The powerful Argentina Industrial Union announced that power and gas cuts have severely impacted production at 5,000 companies across Argentina, and warned the situation might pose a risk to Argentina's economic growth. Substantial media coverage forced GoA officials, including Minister De Vido (who had earlier publicly and repeatedly denied the existence of an energy crisis) to acknowledge the gravity of the situation and to take further measures.

GoA Fix: Emergency "Total Energy" Plan

19. (SBU) In early July, the GoA won Brazil's support to significantly increase imports of expensive (\$220 KW hour) Brazilian electricity from roughly 500 MW to 1,000 MW/day. The GoA also announced an emergency plan to increase electricity generation by thermo-electrical plants. The idea, dubbed "Total Energy," is to subsidize, at a cost of US\$300 million over three months, the use of diesel fuel by electricity generators and industry in order to free up some 5.8 million cubic meters of natural gas for the thermo plants. Planning Minister De Vido announced that natural gas shortages should ease as temperatures rise and promised that CNG sales would shortly resume. Recent higher temperatures in the country, rain in the Patagonia region and consequent greater electricity production have eased the crisis in the past week and CNG supplies in Greater Buenos Aires were fully restored July 7.

Energy Crisis: Impact on Growth?

110. (SBU) With growth averaging over 8% for the past four years, Argentina's macro-economic performance has consistently surpassed market projections. In 2007, Argentina's GDP growth is projected in the 7.5% range - a

growth rate that already factors in a consensus forecast by local economists that industrial production cutbacks due to energy shortages will shave about 0.2- 0.3% off of GDP growth this year. Interestingly, debate among local economic analysts is less focused on the impact of energy cutbacks on industrial production than on whether the GoA's weak peso, high inflation macro policy mix will permit a soft landing towards more sustainable out-year growth levels in the 5-6% range.

¶11. (SBU) June GoA industrial production (IP) statistics, previewed by President Kirchner July 19, show the increase in IP down only a nominal 0.1% from the prior month. Anecdotal evidence suggests that, in anticipation of energy interruptions during the austral winter, industrial owners had invested in plant-specific generators or took other measures to ensure they could operate their plants (at least partially) in the event of electricity or gas interruptions. However, according to respected economic think tank FIEL, IP dropped in May for the first time in 22 months due to energy

shortages. FIEL has been reporting flat IP for several months now, while the GoA still sees production as increasing. This difference likely derives from varying weighting systems for different sectors incorporated by the GoA and FIEL IP index calculations.

No Tariff Increases and No Call to Conserve

¶12. (SBU) Despite the GoA's late-in-the-game acknowledgement of an energy crisis, the government has assiduously avoided supporting the one fix recommended by most market players here: Increasing below-market gas and electricity tariffs to allow prices to play their proper role in regulating consumption. To be fair, the GoA has allowed nominal increases in industrial electricity rates charged by distributors over the past two years, including by U.S. electricity distributor AES and by UK/Spanish gas distributor Metrogas. But "comprehensive reviews" for gas and electricity tariffs promised by the Planning Ministry Energy Secretariat to distribution companies have been repeatedly

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deferred, most recently until sometime in 2008, well after presidential elections. The GoA has also attempted to encourage new private investment in electricity generation capacity by promising that regulated electricity wholesaler CAMMESA will pay higher rates to new generators. However, in a July 19 radio interview, Planning Minister DeVido emphasized that residential electricity and gas rates "will not be touched." He also repeated a longstanding message that companies profiting from their investments in Argentina's electricity sector must meet their "social responsibility" to invest in new capacity.

¶13. (SBU) Also striking in its absence has been any call on GoA consumer to conserve their appetite for cheap energy. On July 16, Planning Minister De Vido said he would not "insult the intelligence" of sophisticated and socially responsible Argentine consumers by asking them to conserve. However, in a recent meeting with the Ambassador, the head of Argentina's largest electricity distributor said that Argentina's current 1.2 GW electricity shortfall could be fully compensated if each of Argentina's 10 million residential households saved the electricity equivalent to that used by two 60 watt bulbs.

Comment: GoA Shortsighted or Simply Pragmatic?

¶14. (C) Public anger at recent energy disruptions have certainly exacted a political cost, but the GoA's band-aid measures to import more electricity from Brazil and to subsidize diesel fuel for Argentine thermal plants will likely see the GoA through to austral Spring elections in October. Our private energy sector contacts agree that

Argentina is in dire need of a wholesale energy policy overhaul that includes not only a liberalization of energy prices but the design and application of a clear pro-investment energy regulatory framework. Gradual electricity and natural gas price adjustments after elections will not be sufficient to compensate for the roughly 1.2 GW (and growing) gap between domestic energy demand and domestic production capacity. And additional public and private thermal and hydro generating capacity due to come on line in the next two years is only forecast to meet incremental demand at current price levels -- not to significantly narrow the current shortfall.

¶15. (C) The Kirchner administration clearly believes that cheap energy that expands consumer purchasing power is its best pre-election strategy, and it has been willing to pay dearly to import peak demand electricity from Brazil and to

subsidize diesel supplies for domestic generators. The still-booming economy has kept the government's public approval ratings high enough that the energy crisis, along with various corruption scandals and a number of recent electoral setbacks for Kirchner-backed candidates in Buenos Aires and the provinces, are viewed as troublesome but not likely to significantly impact October presidential elections. While this approach to the energy crisis is certainly shortsighted, a GoA focused no farther than upcoming elections views it as eminently pragmatic.

WAYNE